

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**Office of the Assistant Secretary for Housing-Federal Housing Commissioner****24 CFR Part 3500****[Docket No. FR-3780-N-02]****RIN 2502-AG40****Mortgage Broker Fee Disclosure Rule: Intent to Establish a Negotiated Rulemaking Advisory Committee and Notice of First Meeting****AGENCY:** Office of the Assistant Secretary for Housing-Federal Housing Commissioner, HUD.**ACTION:** Intent to establish committee and notice of first meeting.

SUMMARY: The Department is considering the establishment of a Negotiated Rulemaking Advisory Committee under the Federal Advisory Committee Act (FACA). The first objective of the Committee would be to determine whether or not the amount and nature of indirect payments to mortgage brokers and certain other mortgage originators (retail lenders) should be disclosed to consumers. Second, the Committee will seek to resolve whether the Real Estate Settlement Procedures Act (RESPA) permits volume-based compensation from wholesale lenders, entities that purchase mortgage loans, to mortgage brokers and, if such compensation is found permissible, whether and how the compensation should be disclosed. The Committee would consist of representatives with a definable interest in the outcome of a proposed rule. HUD has prepared a charter and has initiated the requisite consultation process pursuant to the FACA, Executive Order 12838, and the implementing regulations. If the charter is approved and a final determination is made to form the Committee, the first meeting will take place in late 1995 or early 1996, after the close of the comment period, in Washington, D.C.; the exact date of the meeting will be announced when it has been finalized.

The Department also recently published a proposed rule on this same subject (60 FR 47650, September 13, 1995). Public comments received on that proposed rule will be given to the members of the committee for their consideration as they are negotiating a new proposed rule.

DATES: Comments must be received by November 24, 1995. The exact date of the first meeting in late 1995 or early

1996, in Washington, D.C., will be announced in a subsequent Federal Register document. Interested persons may also contact David Williamson, at the telephone number listed under **FOR FURTHER INFORMATION CONTACT**, for this information.

ADDRESSES: Interested persons are invited to submit comments regarding the proposed Committee and membership to the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410-0500. Comments or any other communications submitted should consist of an original and four copies and refer to the above docket number and title. Facsimile (FAX) comments are *not* acceptable. The docket will be available for public inspection and copying between 7:30 a.m. and 5:30 p.m. weekdays at the above address.

The location for the first meeting in late 1995 or early 1996 will be: the Office of Administrative Law Judges, Washington Office Center, 409 3rd Street SW., Suite 320, Washington, D.C. 20024.

FOR FURTHER INFORMATION CONTACT: David R. Williamson, Director, RESPA Enforcement Unit, Department of Housing and Urban Development, Room 5241, 451 Seventh Street SW., Washington, DC 20410-0500; telephone (202) 708-4560, or on e-mail through Internet at drwilliamson@hud.gov. The TDD number for persons who are hearing- or speech-impaired is (202) 708-4594 (TDD). (These telephone numbers are not toll-free.)

SUPPLEMENTARY INFORMATION:**Background****Issue 1: Mortgage Broker Fee Disclosure**

Since the enactment of the RESPA (12 U.S.C. 2601 *et seq.*) in 1974, the mortgage lending industry has experienced a rapid evolution due, in part, to major technological advances, innovative business entities, and new types of business relationships that serve consumers in single lending transactions. Much of the change that has occurred is attributable to the impressive growth of the secondary mortgage market. By the early 1980s, secondary market entities, such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), not only bought major amounts of mortgage loans, but repackaged many of these loans and sold them as mortgage-backed securities, allowing them to

purchase even greater numbers of lenders' mortgage loans.

A further industry development since the passage of RESPA is that many loans are purchased by, or servicing is transferred to, a wholesale lender at, or shortly after, closing, with the retail lender serving as the intermediary between the consumer and the purchasing entity. When a retail lender serves as an intermediary, it may perform services in processing the loan for which it is compensated. Such compensation may be "direct", where the fees are paid directly by the consumer, or "indirect", where fees are paid by the wholesale lender to the retail lender. The issue arises over whether under RESPA, the amount and the nature of indirect compensation must be disclosed to the consumer, and if so, in what form.

The Congress enacted RESPA in order to avoid unnecessarily high prices and to ensure that consumers were afforded timely and effective information as to the nature and costs of real estate settlement service transactions. To this end, Section 4 of RESPA (12 U.S.C. 2603) requires the Secretary to create a uniform settlement statement that "shall conspicuously and clearly itemize all charges imposed on the borrower * * * and the seller in connection with the settlement" (Section 4(a)). Section 5(c) of RESPA further requires the provision of a "good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement * * *." 12 U.S.C. 2604(c).

Under HUD's current rules, the disclosure of all fees paid to retail lenders, including all compensation from wholesale lenders, is required where the retail lender is being compensated as part of the settlement transaction. 24 CFR 3500.5(b)(7); Appendix B, Fact Situations 5 and 11. This same disclosure requirement has not been applied to subsequent purchases of loans by wholesale lenders on the theory that Congress only intended to cover costs related to the initial settlement transactions.

The Department's current regulations, therefore, treat compensation to the retail lender under three settlement situations somewhat differently, depending upon how the loans are funded at settlement. First, there must be a disclosure of any fees paid by consumers where the retail lender processes the loan from start to finish, funds the loan, and closes the loan in its own name. Subsequent sales of the loan to a wholesale lender, however, would require no further disclosures. Second, where loan funds are provided by the

wholesale lender and the loan is closed in the wholesale lender's name, current RESPA regulations require that indirect, as well as direct, payments to the retail lender and the wholesale lender be disclosed. Under the third method of origination, a loan is processed by, and closed in the name of, the retail lender with a simultaneous advance of loan funds to the retail lender by the wholesale lender, and an assignment of the loan and servicing rights to that wholesale lender ("table-funding"). The Department has determined that all compensation received by a mortgage broker in such a table-funded transaction is subject to disclosure.

The Department's current rules treat mortgage brokers in table-funded transactions as *settlement service providers* ancillary to the loan, akin to title agents, attorneys, appraisers, etc., whose fees are subject to disclosure. This interpretation does not view a mortgage broker as the functional equivalent of a mortgage lender. The salient criterion for this conclusion is the source of funds—unlike a mortgage lender, the mortgage broker in a table-funded transaction does not close the loan with its own funds. Conversely, a mortgage broker using its own funds, or with a "warehouse" line of credit for which it is liable, is not viewed as a mortgage broker but rather as a mortgage lender under the extant HUD interpretation.

HUD's interpretation has given rise to some controversy. Opponents contend that the Department's reading of RESPA's disclosure requirements to include indirect charges and payments that the borrower funds is too expansive. First, they argue that indirect compensation need not be separately enumerated since it is already reflected in direct charges. They further assert that all the consumer needs to know is enough to compare the ultimate cost to the consumer of competing products. Second, critics argue that such loans are akin to, and should thus be treated as, secondary market transactions. Mortgage brokers further complain that an unlevel playing field is created since mortgage bankers do not bear the burden of disclosing the terms of a subsequent sale of the loan. They argue that the competitive disadvantage is amplified by the fact that the Department makes mortgage brokers subject to the requirements of Section 8 of RESPA, adding a level of scrutiny that does not apply to transactions of other originators who sell their loans to wholesale lenders following settlement. They also assert that HUD's interpretation, insofar as it places retail lenders at a competitive disadvantage,

deters the expansion of access to mortgage credit for "non-traditional" borrowers.

Issue 2: Volume-Based Compensation

Volume-based compensation is a payment of money or any other thing of value, as defined by the RESPA regulation, § 3500.14(d), that a wholesale lender provides to a retail lender, based on a number or dollar value of loans that the retail lender sells to the wholesale lender in a fixed period of time. Volume compensation also encompasses volume discounts, wherein a retail lender, who is to provide a stated volume of loans, is given a lower "start-rate" than the wholesale lender's advertised rate, and the retail lender keeps a differential between the start rate and the advertised rate as part of its compensation at settlement.

HUD has never enunciated a formal policy on whether volume-based compensations are permissible under RESPA. Critics of volume-based compensation argue that permitting such payments may lead to loan-steering. Arguably, the consumer's interest (in seeing a range of loan options) may be subordinated to the interest of the retail lender in receiving greater compensation from a particular wholesale lender. Moreover, additional compensation for loans closed above a threshold number, where no added services are provided, could, standing alone, violate Section 8 of RESPA.

Other critics argue that, if the retail lender originates in its own name, the consumer is generally unaware that the retail lender has wholesale options available and may not even be consciously aware of the retail lender's intention to sell the mortgage. It is also conceivable that the retail lender may influence the consumer not to select a favorable loan package so that the retail lender can increase its volume of business with a lender which offers volume compensation.

Consumers may, however, benefit from volume-based compensation. A retail lender will strive to obtain the higher price available from volume compensation. To obtain the needed volume of business, the retail lender may pass along part of the higher price to the consumer in terms of lower points or other cost savings. Retail lenders required to make disclosure could also argue that HUD has created an "uneven playing field" between mortgage bankers and other retail lenders, inasmuch as the issue of volume-based compensation is not relevant for mortgage banker transactions.

In addition to volume-based compensation, retail lenders also receive compensation from wholesale lenders under a variety of names, the most common of which are "servicing release premiums", "yield spread premiums", "yield spread differentials" or "overage". These terms generally refer to any compensation paid to or retained by a retail lender based upon the difference in the interest rate provided in the sold loan and some other benchmark interest rate. It compensates the retail lender for a loan priced at a rate higher than that at which the wholesale lender would otherwise have been willing to accept the loan. A "servicing release premium" is any compensation paid to a retail lender for the release of rights to service the loan. The concerns regarding such forms of compensation are similar to those expressed regarding volume based compensation, that is, do they constitute kickbacks or fee-splitting for delivery of the loans.

Regulatory Negotiation

Negotiated rulemaking has emerged in recent years as an alternative to conventional procedures for drafting proposed regulations. The essence of the concept is that, in appropriate circumstances, it is possible and preferable to bring together agency representatives and all parties substantially affected by the subject matter of the regulation in order to negotiate the terms of the proposed rule. The literature identifies two principal purposes of negotiated rulemaking: to gather information so that agency regulation results in better-informed and well-fashioned rules, and to attempt to reach consensus as to the text of the rule by a process through which negotiators evaluate their own priorities and make tradeoffs to achieve an acceptable outcome on the issues of greatest importance to them. Each element is an extremely valuable outcome of the regulatory negotiation process.

If a consensus is achieved, the resulting rule will likely be easier to implement and less subject to subsequent litigation. Even if consensus is not reached, the process may prove valuable as a means of better informing the regulatory agency of the issues and the concerns of the affected interests.

The final convening report was provided to HUD in September 1995, and concludes that "negotiated rulemaking would be appropriate and feasible and that this process may offer the best means of accommodating the difficult issues involved here." A copy of the report, titled *Convening Report for Regulatory Negotiations on Mortgage*

Broker Fee Disclosures, is available in the office of the Rules Docket Clerk at the above address.

Chartering of Reg-Neg Committee

As a general rule, an agency of the Federal Government is required to comply with the requirements of the Federal Advisory Committee Act (FACA) when it establishes or uses a group of non-Federal members as a source of advice. Under FACA, HUD must receive a charter for this reg-neg committee. HUD has prepared a charter and sent it to the Office of Management and Budget for approval. If the charter is approved and schedule changes are not necessary as a result of public comments, the Committee will be convened in accordance with this notice.

Substantive Issues for Negotiation

The convening report noted that regulatory negotiation could lead to uniform disclosure requirements for all retail lenders either: (1) to require the disclosure of all direct fees paid to retail lenders by borrowers *and* to require disclosure of all indirect fees paid to retail lenders by wholesale lenders; or (2) to require the disclosure of all direct fees paid to retail lenders by borrowers only. In addition to or instead of modifying the rules on disclosure of fees in loan transactions, HUD may choose to redefine what constitutes a "secondary market transaction". As set forth above, such transactions are exempt from RESPA including, *inter alia*, its disclosure requirements, its prohibitions against kickbacks and referral fees, and its requirement that all compensation be reasonably related to the goods or services provided. A "secondary market transaction" could be defined as a loan transaction involving: (1) The sale of a loan by a retail lender to a wholesale lender occurring after settlement (the position in the current regulations); (2) the sale of a loan by a retail lender at any time—before, contemporaneous with, or after settlement; or (3) the sale of a loan on some other date, such as after the first accrual date for the loan following settlement, *i.e.*, the date the first payment is due from the borrower under the loan.

Combining various options for requiring disclosure of direct and indirect fees, or disclosure of direct fees only, with the three possibilities for defining the secondary market transaction, results in at least six alternative approaches to regulating settlement transactions under RESPA. Each of these six alternatives would have a different effect on each of the

major types of loan transactions described above, including: (1) loan closing and subsequent assignment of the loan; (2) loan closing in the wholesale lender's name using the wholesale lender's funds; and (3) table-funding. None of these alternatives will affect a fourth type of transaction—a portfolio transaction where a retail lender processes, funds and closes a loan in its own name for its own portfolio and the lender then holds the loan (if the loan is sold at all, it occurs long after settlement). The alternatives, or possible combination of requirements, available to the Committee include requiring the:

(1) Disclosure of direct and indirect fees at settlement and classification of a loan sale as a "secondary market transaction" only if it occurs after settlement;

(2) Disclosure of direct and indirect fees at settlement and the classification of any loan sale—before, contemporaneous with, or after settlement—as a "secondary market transaction";

(3) Disclosure of direct and indirect fees at settlement and the classification of loan sales following the first accrual—the date the first payment is due from the borrower under the loan—as "secondary market transactions";

(4) Disclosure of only direct (not indirect) fees at settlement and the classification of a loan sale as a "secondary market transaction" only if it occurs after settlement;

(5) Disclosure of only direct (not indirect) fees at settlement and the classification of a loan sale, at any time, as a "secondary market transaction"; and

(6) Disclosure of only direct (not indirect) fees at settlement and the classification of a loan sale as a "secondary market transaction" only if it occurs after the first accrual date.

As to volume-based compensation, those arguments identified in the "Issue 2" section above define the issues likely to arise in negotiations. Additionally, if negotiated rulemaking leads to a conclusion that such compensation is allowable under RESPA, the question also arises as to whether and how the payment should be disclosed on the Good Faith Estimate and the HUD-1 and HUD-1A forms.

Committee Membership

The convener consulted and interviewed over 30 officials of various organizations interested and affected by the mortgage fee disclosure rule. These include the National Association of Mortgage Brokers, the Mortgage Bankers Association of America, the Mortgage

Capitol Group, the American Bankers Association, and America's Community Bankers. The convener also concluded that it was essential that the Committee include an appropriate number of consumer advocates. Moreover, the convener felt that it was important to include participation from the national group representing state financial regulators, the American Association of Residential Mortgage Regulators, due to its active and important role in consumer protection issues and its expertise, especially in the real estate arena.

The convener recommended the inclusion of additional entities, either because of their technical expertise in real estate settlement issues or by virtue of their interests in issues ancillary to this regulation. Those recommended by the convener included the National Association of Realtors, because many of its member realtors are also mortgage brokers and mortgage lenders, and RESPRO, whose members are diversified affiliated real estate settlement service providers and include large real estate companies, controlled businesses, and mortgage providers.

Finally, the convener recommended two Government-Sponsored Enterprises—the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)—for inclusion, because of their importance in determining what constitute secondary mortgage market transactions for purposes of RESPA.

After reviewing the recommendations by the convener, HUD has tentatively identified the following list of possible interests and parties:

Tentative List of Regulatory Negotiations Committee Membership

National Industry Groups

1. Paul Reid, President, American Home Funding, Richmond, VA, President-Elect, Mortgage Bankers Association of America, 1125 15th Street, NW., Washington, DC 20005-2766
2. David Shirk, Member of Board of Directors, National Association of Mortgage Brokers, 1735 N. Lynn Street, Suite 950, Arlington, VA 22209
3. John Rasmus, Esq., Senior Federal Administrative Counsel/Manager, Agency Relations, American Bankers Association, 1120 Connecticut Avenue NW., Washington, DC 20036
4. Glen Gimble, Esq., Program Manager and Counsel, Real Estate Lending Compliance, America's Community Bankers, 900 19th Street, NW., Washington, D.C. 20006

5. Roy DeLoach, Policy Representative, Business Issues, National Association of Realtors, 700 Eleventh Street NW., Washington, D.C. 20001-4507
6. Sue Johnson, President and Executive Director, RESPRO, 1800 M Street NW., Suite 900 South, Washington, D.C. 20036
7. David Goldberg, The Mortgage Capitol Group, Senior Vice President, Administration, PHH Mortgage Services Corporation, 6000 Atrium Way, Mt. Laurel, NJ 08054

Consumer Groups

1. Robert Creamer, Citizen Action, 1730 Rhode Island Avenue NW., Washington, DC 20036
2. William J. Brennan, Jr., Esq. (Member, Board of Directors, National Association of Consumer Advocates), Home Defense Program of the Atlanta Legal Aid Society, 340 West Ponce De Leon Avenue, Decatur, Georgia 30030
3. Nina Simone, Esq., Jean Davis, Esq., Legal Counsel for the Elderly, American Association of Retired Persons, 601 E Street NW., Washington, DC 20049.

State Organizations

1. Craig Jordan, Esq., Assistant Attorney General for the State of Texas, Consumer Affairs Division, 714 Jackson Street, Suite 800, Dallas, Texas 75202
2. Daniel Muccia, President, American Association of Residential Mortgage Regulators and Deputy Superintendent of Banks, State of New York Banking Department, Two Rector Street, New York, New York 10006

Government-Sponsored Enterprises

1. Jim Newell, Esq., Associate General Counsel, Federal Home Loan Mortgage Corporation, 8200 Jones Branch Drive, McLean, VA 22102-3107
2. JoAnn Carpenter, Esq., Vice President and Deputy General Counsel, Federal National Mortgage Association, 3900 Wisconsin Avenue N.W., Washington, DC 20016-2899

Federal Government

Designated Federal Officer: Sarah X. Rosen, Esq., Special Assistant to the Assistant Secretary for Housing, Room 9100, U.S. Department of Housing and

Urban Development, 451 7th Street S.W., Washington, D.C. 20410, (202) 708-3600

Comments and suggestions on this tentative list of Committee members are invited. HUD does not believe that each potentially affected organization or individual must necessarily have its own representative. However, HUD must be satisfied that the group as a whole reflects a proper balance and mix of interests. Negotiation sessions will be open to members of the public, so individuals and organizations that are not members of the Committee may attend all sessions and communicate informally with members of the Committee.

Requests for Representation

If in response to this Notice, an additional individual or representative of an interest requests membership or representation on the Committee, HUD, in consultation with the convener, will determine whether that individual or representative will be added to the Committee. Each additional nomination for membership on the Committee must include the name of the nominee and a description of the interests the nominee would represent, evidence that the nominee is authorized to represent relevant parties, a written commitment that the nominee shall participate in good faith, and the reasons that the members proposed in this notice do not adequately represent the interests of the person submitting the nomination. HUD will make the decision on membership based on whether the individual or interest would be substantially affected by the proposed rule and whether the individual or interest is already adequately represented on the Committee.

Final Notice Regarding Committee Establishment

After reviewing any comments on this Notice and any requests for representation, HUD will issue a final notice. That notice will announce the establishment of a Negotiated Rulemaking Advisory Committee, unless HUD's charter request is disapproved, or HUD decides, based on comments and other relevant considerations, that such action is inappropriate.

Tentative Schedule

If HUD determines that the Committee should be formed and negotiations started, HUD plans to hold the first meeting of the Committee in late 1995 or early 1996, after the close of the 30-day comment period on this notice and the approval of the Committee's charter. The meeting will be for two and a half days, with the first day starting at 10:00 a.m. and running until completion; the second day starting at 9:00 a.m. and running until completion; and the last day starting at 9:00 a.m. and running until approximately 1:00 p.m. The exact dates of the meeting in Washington, D.C., will be announced in a subsequent Federal Register notice. The location of the meeting will be: the Office of Administrative Law Judges, Washington Office Center, 409 3rd Street, SW, Suite 320, Washington, D.C. 20024, (202) 708-5004. The facilitator for the Committee will be the Honorable Alan W. Heifetz, Chief Administrative Law Judge. The purpose of the first meeting will be to orient members to the reg-neg process, establish a basic set of understandings and ground rules (protocols) regarding the process that will be followed in seeking a consensus, and begin to address the issues. This meeting is open to the public.

Decisions with respect to future meetings will be made at the first meeting and from time to time thereafter. Notices of future meetings will be published in the Federal Register, if time permits.

To prevent delays that might postpone timely issuance of a proposed rule, HUD intends to terminate the Committee's activities if the Committee does not reach consensus within 5 months of the first meeting. The process may end earlier if the facilitator believes that sufficient progress cannot be made or that an impasse has developed that cannot be resolved.

Authority: 42 U.S.C. 1437g, 3535(d).

Dated: September 29, 1995.

Nicolas P. Retsinas,

Assistant Secretary for Housing-Federal Housing Commissioner.

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